

MANAGER'S BUDGET ADDENDUM #8



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Peter Jensen
Scott Johnson
Larry Lisenbee

**SUBJECT: SUPPLEMENTAL INFORMATION
ON CITY HALL RELATED ISSUES**

DATE: May 17, 2006

Approved

/s/

Date 05/17/06

BACKGROUND

This memorandum, first issued as a supplemental memorandum regarding agenda items on the May 16 City Council agenda, provides additional information related to City Hall costs, the history of budget approvals related to City Hall, and other issues relevant to discussions and questions that have arisen as part of the budget process dialogue. We are re-issuing the memorandum as a Manager's Budget Addendum in order to provide the Council and public with information which may prove helpful during the budget deliberations.

The business and development community has raised questions, as a result of proposed fee increases, about the assessments to non-General Fund sources to properly distribute these costs. These questions are related to the effect of the assessments on the proposed fee increases, and the comparability of the assessments to rents paid in privately-owned buildings.

Other questions have been raised regarding the City's compliance with Measure I, which allowed City Hall to be relocated downtown "so long as the costs are paid by using the proceeds from the sale or lease of the old civic complex and other land, savings from the elimination of leased office space, and consolidation of city facilities and services."

ANALYSIS

This section is arranged in Question and Answer format in order to address issues of interest.

Q: The information memo provided to Council last week detailed total costs for City Hall as described above. What elements of those costs have been approved by Council and when?

A: Attachment A presents a chronology of the various actions related to approvals of City Hall and its costs. The Council has approved all of the costs, including financing costs associated with the issuance of bonds and commercial paper.

Q: Does the recommendation in item 2a of the Financing Authority agenda change those total costs? If so, how?

A: Yes. For construction bonds, the recommendation would add \$7.2 million in earned, but unbudgeted interest, and would spend it according to the Council's direction contained in the Mayor's March Budget Message. For commercial paper, the recommendation would add \$2.075 million, up to the previously Council-approved limit of \$38.46 million (\$45.25 million less 15%). The costs presented in the May 1 information memo only included the \$36.4 million in commercial paper that the Council has approved for issuance.

Q: How are these costs spread to City departments in the form of cost allocations related to the space? What is the basis of these allocations?

A: The debt service costs for City Hall, the 4th & St. John Garage, and the technology, furniture, equipment and relocation (TFE & R) costs are allocated to the General Fund and 51 special and capital funds. City Hall operating and maintenance costs are budgeted in the General Fund and the proportional share of those costs that should be borne by special and capital funds are recovered through the overhead process.

Debt service and TFE & R costs are allocated based on two factors. The first factor allocates costs for space occupied by employees and departmental functions based on the percentage of space related to activities supported by each particular fund. The second factor allocates costs for spaces used by all City departments (whether or not they have offices in City Hall), such as the Council Chambers and committee rooms, based on the percentage of total employees City-wide supported by each fund. Within the General Fund, costs associated with fee-supported activities are allocated in the same way.

The allocation of City Hall costs was first discussed in the 2005-2009 General Fund Forecast issued in March 2004 and were approved by Council as part of the 2004-2005 (start-up costs only) and 2005-2006 (operating and maintenance costs and debt service costs) Adopted Operating and Capital Budgets. These costs were also discussed in concept with the development community starting in 2005-2006.

Q: How do these cost allocations affect fees charged to the public?

A: The assessments to various funds are included as one cost component of the budget for that fund. In the case of General Fund fee-supported activities, the assessment is a part of the cost calculation used to determine cost recovery for that fee. The impact of the assessment on the fee can vary significantly, depending upon the relative size of the assessment, and on whether activities associated with that fund or fee had been housed in leased space or in the old City Hall. A program previously housed in leased space already had a cost related to space, so the effect of the assessment is incremental. A program previously housed in old City Hall had very low building costs, since the City had already paid off debt service related to its construction, so the effect of the assessment is more significant.

Q: How do these cost allocations affect developer fees?

- A:** As described above, the assessment has been included in the cost calculation for developer fees, which are set at 100% cost recovery. Because development services functions were housed in old City Hall, space costs have increased significantly. To help mitigate this impact, City Hall allocations are being phased into the cost calculation over a five-year period, which began in 2005-2006.

In 2006-2007, total fee increases proposed for various development fee programs range from 4.5% to 7%. These fees, along with the use of development reserves, will cover increased costs in the 2006-2007 Proposed Operating Budget, thereby keeping cost recovery at 100%. Of these increased costs, 13% is due to the City Hall cost allocation. Approximately 30% of the increase is due to proposed staffing additions and one-time non-personal funding additions to improve service levels. The remainder is due to rising personnel costs and increases in funding for non-personal/equipment expenditures.

- Q:** How do these cost allocations compare to rents that would be charged to tenants in a private building?

- A:** The cost allocations use a different model than private landlords do, in that non-tenants pay a portion of the common area costs, as described above, and the allocation includes costs for the underground and 4th & St. John garages, whereas private landlords charge separately for parking.

If City Hall tenants were charged in the same way that private office tenants are charged, the equivalent rental rate would be \$5.29 per square foot. As mentioned above, our intent had been for the allocations for City Hall costs to be phased in for development services fees over a period of five years. Because of the phase-in plan, the equivalent rental rates mentioned above are lower for these services: approximately \$2.65 per square foot.

Existing downtown Class A space rental rates averaged \$3.12 in April 2006, according to Ritchie Commercial. This figure focuses on rates being paid by current tenants, which is the rate that has been used for Measure I analysis, rather than rates available for new tenants interested in currently vacant space.

The Council can consider other alternatives to the five-year phase-in plan. Possible alternatives include a longer phase-in period, pegging the allocations to a Class A market-based index instead of actual City Hall costs, or a cap at a specified percentage level of growth. Either of the two latter alternatives would result in an exception to the full cost-recovery directive regarding these programs, thereby resulting in a General Fund subsidy to the programs. If the Council is interested in exploring these or other alternatives, they could be studied in more depth and brought forward as part of next year's budget process prior to implementing the remaining years of the current five-year phase-in plan.

- Q:** Do the costs presented in the original memo affect the City's compliance with Measure I?

- A:** The original language of Measure I is included above. Attachment A details that the City first certified compliance with Measure I in 1999, and re-certified in 2001, along with the terms of the settlement of the Measure I litigation brought by Al Ruffo, which provides that the court may determine whether additional Measure I analysis is needed if certain triggers relating to cost changes are met. Attachment B presents the key elements of the 2001 Measure I re-certification, and provides updated current projected or actual amounts for these elements, where possible.

This attachment shows that none of the triggers have been met. The chart below shows the triggers and current status:

Trigger	Current Status
Total construction costs for City Hall and garage exceed \$415 million	Construction costs are estimated at \$295.6 million.
Average rental rates for Class A buildings in downtown San Jose fall below \$33 per square foot on an annual basis for six consecutive months	Existing downtown Class A Office rental rates averaged \$37.44 on an annual basis for the month of April 2006.
Annual national inflation rate becomes less than 1.5% for six consecutive months	The national inflation rate has not met this trigger since the settlement. The most recent national inflation rate is 3.4% for March 2006.
Estimated operating & maintenance costs for City Hall exceed \$17 per square foot per year	Current O & M costs are \$14.87 per square foot per year.

Q: What will debt service payments be if the recommendations are approved? How do they compare to savings realized due to moving out of leased space?

A: In 2006-2007, debt service payments for the New City Hall and Garage are estimated to be \$19.1 million, and debt service payments for Technology, Furniture, Equipment and Relocation are estimated to be \$6.0 million.

Estimated annual lease savings are \$10.5 million (based on 2004-2005 rates in space leased by the City at that time). The Measure I analysis was based on a 54-year period, and included a number of other cost and savings elements, consistent with the language of the measure. These savings are lower than those in the Measure I analysis because rental rates are considerably lower than had been projected in the 2001 re-certification analysis..

PUBLIC OUTREACH

Meetings with the development community have been held to discuss the elements of the fee program presented in this memorandum.

COORDINATION

This memorandum has been coordinated with the Planning, Building, and Code Enforcement Department.

/s/
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/s/
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Director of Finance

/s/
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For questions please contact Peter Jensen, Director of General Services, at 408-938-2025, Scott Johnson, Director of Finance, at 535-7001, or Larry Lisenbee, Budget Director, at 535-8144.

Attachment A

City Hall Chronology

1994 Studies Regarding Space Needs

The City Council approved funding for the completion of a Civic Center Operations Plan Study. This recommendation was based on analysis, which indicated that in the long-term, it makes economic sense to own rather than lease space.

June 1996 “Strategic Planning: Phase One San Jose Civic Operations Master Plan”

The study was completed by the consulting team of Simon Martin-Vegue Winkelstein Moris, Sedway Kotin Mouchly Group and The Steinberg Group and distributed to the City Council.

Aug. 1996 Measure I Language approved by Council

As a result of the 1996 space study, the City Council approved the following “Measure I” language for the November 1996 ballot:

Without imposing additional taxes or taking money from other city programs, shall Ordinance No. 14224.1 be amended to permit the relocation and consolidation of civic offices in the downtown so long as the costs are paid by using the proceeds from the sale or lease of the old civic complex and other land, savings from the elimination of leased office space, and consolidation of city facilities and services?

Nov. 1996 Measure “I” Passed By Voters

The voters approved Measure I with over 60% of the vote and Ordinance 14224.1 was amended accordingly.

April 1997 Formation of Civic Center Complex Relocation Task Force Approved

Council approves the creation of a Civic Center Complex Relocation Task Force to study the options for moving City Hall to an alternate location, in the downtown area.

June 1997 Downtown Site Selected

Civic Center Relocation Task Force recommends and Council approves a downtown site at 4th and West Santa Clara Streets.

Sept. 1998 City Hall Relocation Economic Feasibility Report Approved

Council approves the Preliminary Economic Feasibility Study reconfirming selection of the downtown site.

Project Area Committee Formed

Council authorizes formation of a Project Area Committee (PAC) to review the proposed Redevelopment Plan for the Civic Plaza Redevelopment Area.

Nov. 1998 Design Architect Selected

The architectural firm of Richard Meier and Partners (RMP) is awarded the contract to develop initial architectural design concepts and produce schematic design drawings.

May 1999 Construction Manager Selected

Council approves the selection of Turner Construction Company (TCCO) as Construction Manager for the project.

June 1999 Certification of Civic Plaza EIR

Council approves certification of Civic Plaza Redevelopment Plan Environmental Impact Report (EIR).

Zoning Plan Amendment and Increased Building Height Approved

Council approves General Plan Amendment to change the land use designations in the Civic Plaza area to Public/Quasi Public and allows an increased building height in this project area.

Civic Plaza Redevelopment Project Area Established

Council approves formation of new project area around the intended site for the new Civic Center, as recommended by the Project Area Committee (PAC).

June 1999 Council Certification of Measure "I"

On June 8, 1999, the City Council adopted Resolution No. 68910 concluding that an updated Financial Model demonstrates moving City Hall to the approved downtown location meets the requirements of Measure "I" and approved an interim financing plan to pay for design, peer review and project consultant work.

June 1999 Parking and Traffic Committee Formed

Council approves the recommendation to form a Parking and Traffic Committee (PTC), as an advisory group to Council.

Dec. 1999 Additional Conceptual Design Presented

Council is presented with five (5) new conceptual architectural designs. Council approves plan for Mayor and Vice Mayor to draft alternative options for Council's consideration.

March 2000 Conceptual Design Finalized and Approved

The Council approves a new design concept which satisfies the requirements of the City Council and the community.

June 2000 Series 2000 Lease Revenue Bonds Issued

The City issues \$31.5 million of lease revenue bonds to pay design and development costs of the New City Hall.

Sept. 2000 Schematic Design Approved and Off-Site Garage Authorized

Council directs staff to proceed to the Design Development Phase and to also pursue financing and construction of an off-site parking garage.

Budget Revisions Directed

Council directs staff to re-examine the project's budget estimate with particular attention to the items contained in the Mayor's memorandum of 9/13/2000.

Sept. 2000 Financial Feasibility Analysis

As part of the project design and budget approval, in September 2000, the Finance Department prepared a memorandum titled, "*Civic Center Relocation Financial Feasibility Analysis*" to prepare an analysis of the City's ability to pay for the debt service, operating and maintenance costs of the new Civic Center and renovated City Hall, and the associated parking costs. The financial feasibility analysis confirmed the City's ability to pay, and was approved by the City Council in conjunction with the approval of the schematic design for the new Civic Center.

Nov. 2000 Budget Estimate Approved

Council approves a project budget of \$325M, which includes \$33M for site acquisition and relocation, \$240M for building development, \$44M for on-site and off-site parking and \$8M for off-site parking acquisition and relocation. Budget amounts are approved predicated on a proposed Multiple Prime construction delivery method.

April 2001 Off-Site Garage Location Approved

Council approves proposed location of off-site parking garage: between 4th and 5th Streets, south of Saint John Street.

Nov. 2001 Measure “I” Recertified

Council recertifies that the project meets the requirements of Measure “I.” The long-term economic benefit by relocating City Hall Downtown is calculated at a net present value savings of \$189M .

City and Redevelopment Agency Cooperation Agreement Amended and Restated

Council approves City compensation to the Agency for costs associated with delivery of Civic Center on-site and off-site properties.

June 2002 Budget Approved

Council approves a project budget of \$343M, which includes \$41.9M for Civic Center land acquisition, \$263.5M for Civic Center construction, \$12.6M for Parking Garage land acquisition, and \$25M for Parking Garage construction.

July 2002 Series 2002A Lease Revenue Bond Anticipation Notes Issued

The City issues \$85.0M of bond anticipation notes to repay the Agency for land acquisition and site preparation costs of the New City Hall and Parking Garage, fund additional land acquisition costs, and pay initial construction costs of the New City Hall.

Nov. 2002 Series 2002B/C/D Lease Revenue Bonds Issued

The City issues \$412.4M of lease revenue bonds to refinance the Series 2002 Bonds, repay the Series 2002A Bond Anticipation Notes, and fund construction costs of the New City Hall.

Jan. 2004 Tax-Exempt Commercial Paper Program Authorized

Council authorizes issuance of up to \$98M of commercial paper notes to fund construction costs of the New City Hall and Parking Garage, technology, furniture, equipment and relocation costs for the New City Hall, improvements to existing City facilities, and reimbursement of Existing City Hall renovation design costs.

Feb. 2005 Budget Increase Approved

Reflecting cost increases associated with delays caused by the PAC SJ lawsuit, Council increases the project budget by \$2.6M, consisting of an increase in New City Hall construction of \$1.5M and an increase in Parking Garage construction of \$1.1M.

VLF Receivable Financing Authorized and Proceeds Committed to Garage

Council authorizes the City to participate in VLF Gap Loan Receivable Financing Program and commits the proceeds to be used to pay costs of the Parking Garage, ultimately reducing the amount of debt issued to pay Parking Garage land acquisition and construction costs.

June 2005 Project Close-Out Contingency Established

Council establishes contingency of \$4.0M, to be funded from interest earnings on the bond proceeds in the project fund, to address estimated project close-out costs. Total project budget with potential close-out costs is \$349.6M.

City Occupies New City Hall

City staff begin relocating to and conducting business in New City Hall.

July 2005 VLF Receivable Proceeds Used to Redeem Parking Garage Commercial Paper

City uses \$14.9M of VLF Financing proceeds to redeem commercial paper notes issued to pay Parking Garage costs. City subsequently receives an additional \$0.6M resulting from the State's early payback of VLF Gap Loan, which is deposited in Parking Garage project fund.

August 2005 Customer Service Center Opens

Customer Service Center opens to the public.

History of Litigation

Feb. 1998 Litigation Commences

Former Mayor, Al Ruffo and others filed a lawsuit challenging the relocation of the City Hall to Downtown. The plaintiffs sued the City and the Agency alleging, among other things, that (1) the Agency's use of tax increment funds for the City Hall project violated State Redevelopment law; (2) that the City's relocation of City Hall violated Measure I and, accordingly, is a waste of public funds under State law ("Waste"); and (3) real property deed restrictions restricted the use of the current City Hall.

Sept. 1999 Court Grants City Motion for Summary Judgment

The trial court grants summary judgment on all causes of action in favor of the City and Agency. Plaintiffs appeal.

August 2001 Appeals Court Reverses Summary Judgment

California Court of Appeals reverses the trial court's grant of a summary judgment on the first two grounds and upholds the trial court's summary judgment in favor of the City regarding the deed restriction cause of action.

April 2002 City, Agency and Plaintiffs Enter Into Stipulated Judgment

The City, the Agency and the plaintiffs enter into a Stipulated Judgment, which specifies that (1) Agency tax increment funds spent on the acquisition of property for the City Hall Project and the Garage Project will be reimbursed with interest by the City upon transfer of the property from the Agency to the City; (2) the current plan for the construction of the City Hall Project and the Garage Project are in compliance with Measure I limitations; and (3) there are no public use deed restrictions on the former City Hall property.

The trial court retains jurisdiction to determine if, and to the extent which, any additional Measure I analysis is required, and any remedy that may be appropriate including injunctive relief, if any of the following events occur, at anytime from the date of the Stipulated Judgment until construction of the new City Hall and the Garage Project are completed: (1) total construction costs for the new City Hall building and the Garage Project, estimated at \$288 million, exceed \$415 million; (2) average lease rates for Class A buildings in downtown San José, estimated at \$42.00 per square foot on an annual basis, fall below \$33.00 per square foot on an annual basis for a period of six consecutive months; (3) the annual national inflation rate becomes less than 1.5% for a period of six consecutive months; or (4) the estimated cost of operating and maintenance expenses for the new City Hall building, estimated to be approximately \$11.00 per square foot per year, exceeds \$17.00 per square foot per year.

Attachment B

Measure I Recertification November 2001 Financial Model Significant Assumptions 2001 Model and 2006 Projected/Actual

	Economic Test
Gross Savings	+\$1.450 billion
Net Present Value of Savings	+\$189.240 million

	2001 Model	Current Projected/Actual
Basic Duration Assumptions		
• Total years of model	59	N/A
• Estimated useful life of building	50	50
Construction Costs (Estimated Cost including inflation)		
• Civic Center	\$244.0 M	\$269.4 M
• Parking	\$44.0 M	\$26.2 M
Land (Estimated Cost including inflation)		
• Acquisition Cost (Civic Center)	\$41.5 M	\$41.9 M
• Acquisition Cost (Parking)	\$13.1 M	\$10.8 M
• Sales Proceeds ("E-Lot")	\$32.1 M	TBD
Rental Information		
• Market Rental Rate (per sq. ft.)	\$42.00	\$39.36 (Mar 06)
• Square Footage Under Lease	297,629	N/A
• Updated Employee Counts for Model	3,854	N/A
O&M Costs per sq. ft.	\$10.73	\$14.87 (Mar 06)
Discount Rate	4.75%	NA
Inflation Rate	3.00%	NA
Borrowing Costs	4.0% - 4.75%	3.77% - 5.20%
Debt Service		
• Gross Principal & Interest	\$877.5 M	\$965.0 M
• Less Interest Earnings	<83.1>M	<93.7>M
• Net Debt Service	\$794.4 M	\$871.3 M
Total Leasing Expenses	\$1,833.7 M	N/A
Schedule (FY Basis)		
• Civic Center Relocation ("Build Scenario")	2006	2006
• City Hall Renovation ("Build Scenario")	2007	TBD

TBD = To be determined

N/A = Not applicable. The 2001 Recertification Model was a snapshot in time based on assumptions relevant at the time and no additional model updates were intended.